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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 251

THE BALTIMORE AND OHIO RAILROAD COMPANY, PETITIONER

v.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE, DISTRICT OF MARYLAND

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 78-107) is reported at 77 F. Supp. 156. The opinion of the Court of Appeals (R. 110-115) is reported at 174 F. 2d 896.

JURISDICTION

The judgment of the Court of Appeals was entered on May 24, 1949 (R. 115). The petition for a writ of certiorari was filed on August 11, 1949. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the petitioner, under Section 23 (c) of the Revenue Act of 1936, could deduct, as accrued in 1936, taxes, the liability for which petitioner was denying and contesting on the basis of the asserted unconstitutionality of the taxing statute.

STATUTE AND RULING INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, * * *

* * * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

I. T. 3116, 1937-2 Cum. Bull. 90:

REVENUE ACT OF 1936

Treatment of amounts accrued and claimed as deductions for the carriers' excise tax in the

income tax returns of carriers for 1936 under the Carriers Taxing Act of 1935 (49 Stat., 974), approved August 19, 1935, in view of the provisions of the Carriers Taxing Act of 1937, Public, No. 174, Seventy-fifth Congress, approved June 29, 1937.

* * * * *

The following practices will be observed by the Bureau:

(a) In those cases in which the carriers' excise tax was paid by the carrier prior to the enactment of the Carriers Taxing Act of 1937, the deduction claimed therefor in the income tax return of the carrier for the calendar year 1936 will be allowed and refunds of such tax will be required to be included in the gross income of the carrier for the year in which the refund is made.

(b) In those cases in which the carriers' excise tax was not paid to the collector and the carrier was not a party to the suit under the Carriers Taxing Act of 1935, or did not otherwise contest liability for such tax, the deduction claimed therefor in the income tax return of the carrier for the calendar year 1936 will also be allowed and the amount of the tax will be included in the gross income of the carrier for the year in which the liability for the tax was extinguished, that is, for the calendar year 1937.

(c) In those cases in which the carriers' excise tax was not paid to the collector and the carrier was a party to the suit under the Car-

riers Taxing Act of 1935, or otherwise contested liability for such tax, the deduction claimed therefor in the income tax return of the carrier for the calendar year 1936 will be disallowed and no adjustment of the income tax return of the carrier for the calendar year 1937 will be made on account of the extinguishment of the carriers' liability for the tax.

STATEMENT

The Carriers and Employees Tax Act of 1935, c. 813, 49 Stat. 974, required all interstate carriers to pay an excise tax of three and one-half percent of the compensation not in excess of $300 per month paid by them to their employees after the effective date of the Act, March 1, 1936, until its expiration date, February 28, 1937. Congress extended the expiration date to June 30, 1938. (R. 79.) On January 6, 1936, most of the railroads throughout the country, including petitioner, joined in the institution of a suit in the District Court for the District of Columbia against the Railroad Retirement Board and others, claiming that the Carriers Taxing Act of 1935 was unconstitutional. A number of railroad employees were permitted to intervene in this suit as parties plaintiff. (R. 79.)

On June 26, 1936, the District Court rendered an opinion holding the Act unconstitutional, *Alton R. Co.* v. *Railroad Retirement Board,* 16 F. Supp. 955, and on June 30, 1936, entered its final decree giving effect to this decision. On July 17, 1936, the defendants took an appeal, but on June 29, 1937, be-

fore the appeal was heard by the Court of Appeals for the District of Columbia, Congress passed the Carriers Taxing Act of 1937, which, according to its express terms, supplanted the Carriers Taxing Act of 1935, and provided (Section 11) that "All monies payable as and for taxes under said Act of August 29, 1935, and not heretofore paid shall cease to be payable and all proceedings pending for the recovery of any such monies shall be terminated." (R. 79.)

In view of this repeal of the 1935 Act by the 1937 Act, the Court of Appeals for the District of Columbia directed the District Court to dismiss the suit since it had become moot. Thereupon, the Internal Revenue Bureau, on August 6, 1937, issued an income tax ruling (I.T. 3116, 1937-2 Cum. Bull. 90), with respect to the treatment of amounts accrued and claimed as deductions for taxes under the 1935 Act by carriers in their income tax returns for 1936. (R. 79-80.) This ruling provided in part as follows (R. 80; see *supra,* pp. 3-4):

> In those cases in which the carriers' excise tax was not paid to the collector and the carrier was a party to the suit under the Carriers Taxing Act of 1935, or otherwise contested liability for such tax, the deduction claimed therefor in the income tax return of the carrier for the calendar year 1936 will be disallowed * * *.

From March 1, 1936, and for the balance of that year, the petitioner accrued on its books the tax imposed upon it by the Act of 1935, that Act being in

force from its effective date, March 1, 1936, throughout the remainder of that year, although the taxpayer was attacking its constitutionality by participation in the litigation, above referred to, from January, 1936, throughout the remainder of that year and until that Act was supplanted on June 29, 1937, by the 1937 Act. The taxpayer never filed any returns under the 1935 Act. (R. 80-81.)

The District Court determined that, under the circumstances, petitioner was not entitled to accrue as a deduction the unpaid and contested tax (R. 78-107); this holding was affirmed by the Court of Appeals (R. 110-115).

ARGUMENT

The precise question presented in the petition has been decided by this Court adversely to petitioner in *Dixie Pine Products Co.* v. *Commissioner,* 320 U. S. 516; and the holding therein has been subsequently reaffirmed by this Court in *Security Mills Co.* v. *Commissioner,* 321 U. S. 281. Pursuant to the principle announced by this Court in the aforementioned cases, the Court of Appeals correctly determined that petitioner, which, together with a number of major interstate carriers, had participated in litigation enjoining the enforcement of the Carriers and Employees Tax Act of 1935, c. 813, 49 Stat. 974, on the basis of its asserted unconstitutionality and had failed to pay the tax levied by the Act, could not accrue the unpaid and contested

tax. In the *Dixie Pine* case this Court, in concluding that a taxpayer which had brought suit in the state court to contest its liability for a state gasoline tax on a solvent used in its business, could not accrue as a deduction the unpaid tax prior to the termination of the litigation, stated (p. 519):

> *Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could not do.* It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated. [Italics ours.]

In *Security Mills Co.* v. *Commissioner, supra,* decided one year after the *Dixie Pine* case, this Court held that a taxpayer which had passed on to its customers as part of the purchase price a processing tax, reimbursing them in later years when the taxing provisions had been held unconstitutional, could not accrue a deduction in the earlier year in which taxpayer had contested its liability and failed to pay the tax. In so holding this Court stated [1] (p. 284):

> It is settled by many decisions that a taxpayer may not accrue an expense the amount

[1] This quoted language was undoubtedly in answer to, and rejection of, the theory expressed by Judge Phillips in his dissenting opinion below, and here suggested by petitioner (Pet.

> of which is unsettled or the liability for which is contingent, *and this principle is fully applicable to a tax, liability for which the taxpayer denies, and payment whereof he is contesting.* * * * Its tax liability, if any, to the United States did not differ from other debts. *Since it denied liability for, and failed to pay, the tax during the taxable year 1935, it was not in a position in its tax accounting to treat the Government's claim as an accrued liability.* [Italics ours.]

Since this Court's decision in the *Dixie Pine* and *Security Mills* cases, the lower courts have uniformly held that a taxpayer may not accrue an unpaid expenditure, the liability for which is denied and contested. *Chestnut Securities Co.* v. *United States,* 62 F. Supp. 574, 576 (C. Cls.); *Sohio Corp.* v. *Commissioner,* 163 F. 2d 590, 593 (C.A. D. C.); cf. *Freihofer Baking Co.* v. *Commissioner,* 151 F. 2d 383 (C.A. 3d); *Brighton Mills* v. *Commissioner,* 161 F. 2d 791 (C.A. 5th).

The facts in the *Dixie Pine* case claimed by petitioner to render that case distinguishable from the present case were not considered material by this Court and were not, outside of the recitation of facts at the commencement of the opinion, even

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16-18), that the liability remained fixed and the tax was required to be accrued prior to the determination that the taxing statute was unconstitutional.

Appended to the first sentence above quoted from the court's opinion is the following footnote:

> See *Dixie Pine Products Co.* v. *Commissioner,* 320 U. S. 516, where this rule of law was reaffirmed and applied by the Board of Tax Appeals, the Fifth Circuit Court of Appeals, and by this court, and cases cited.

once referred to by this Court in deciding the case. That the state authorities in the *Dixie Pine* case may have admitted some doubt as to taxpayer's liability while the Commissioner at no time expressed a doubt as to the validity of the Carriers and Employees Tax Act (Pet. 11-12) is of no significance since in both cases the liability was vigorously asserted and contested. That taxpayer in the *Dixie Pine* case did not accrue the tax liability on its books in the ordinary course of business while petitioner did so accrue the liability (Pet. 12) is of no moment since accruability depends on whether all the events which fix the fact and amount of liability have occurred in the taxable year, not on taxpayer's book entries. *Lucas* v. *American Code Co.*, 280 U. S. 445, 450-451; *United States* v. *Anderson,* 269 U. S. 422, 435; *Louisville Provision Co.* v. *Commissioner,* 155 F. 2d 505, 511 (C.A. 6th); *Continental Baking Corp.* v. *Helvering,* 77 F. 2d 119, 120 (C.A. D. C.). Nor is it material that petitioner was one of a large number of carriers contesting liability under the taxing statute while the Dixie Pine Company brought suit as the sole plaintiff. (Pet. 12-13.) Both the Dixie Pine Company and the petitioner vigorously denied liability, refused payment during the taxable years and brought suit to enjoin collection of the tax, thus rendering their liability contingent. It may be further observed that the Security Mills Company was certainly not the only mill to actively contest the constitutionality of the Agricultural Adjust-

ment Act of 1937, c. 25, 48 Stat. 31. *E.g., Freihofer Baking Co.* v. *Commissioner,* 151 F. 2d 383 (C.A. 3d); *Brighton Mills* v. *Commissioner,* 161 F. 2d 791 (C.A. 5th); *United States* v. *Butler,* 297 U. S. 1. Whether a carrier which had not joined in the suit would be entitled to accrue the deduction for the tax is not involved here. Similarly without relevance is the fact that the Dixie Pine contest was grounded on the asserted nonapplicability of the statute while the contest here was based upon the asserted unconstitutionality of the taxing statute. (Pet. 12-13.) It is not the legal basis of the suit but the fact of the denial of liability and the contest which render that liability contingent. The invalidity of the attempted distinction is conclusively demonstrated by the fact that this Court granted certiorari in the *Dixie Pine* case because of a "conceded conflict in principle" (*Dixie Pine Products Co.* v. *Commissioner,* 320 U. S. 516, 518) with the decisions rendered in *Commissioner* v. *Central United Nat. Bank,* 99 F. 2d 568 (C.A. 6th); *J. A. Dougherty's Sons* v. *Commissioner,* 121 F. 2d 700 (C.A. 3d); and *Davies' Estate* v. *Commissioner,* 126 F. 2d 294 (C.A. 6th), in all of which the liability was contested on the theory that the taxing statute was unconstitutional. Cf. *Security Mills Co.* v. *Commissioner,* 321 U. S. 281.[2]

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[2] Other distinctions suggested by petitioner are equally untenable. That the court directed the carriers to hold amounts already collected from employees in special accounts and that its amended decree provided that nothing in the original decree should be construed so as to forbid the payment of the

Petitioner's suggestion (Pet. 24-28) that, under the Commissioner's theory and presumably under the *Dixie Pine* decision, a proper accrual could be postponed at will by the filing of suit asserting nonliability is ill-founded. Suffice it to point out that only a real contest would create a contingency. At any rate that issue is not involved here since it is apparent that petitioner was "strenuously contesting liability in the courts and, at the same time, deducting the amount of the tax." *Dixie Pine Products Co.* v. *Commissioner,* 320 U. S. 516, 519. That it may not do so is now settled.

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tax to the Commissioner (Pet. 15-16) are of no significance since the carriers did not in fact pay over the taxes to the Commissioner, and continued to assert nonliability. The Congressional extension of the statute (Pet. 16-17) was patently ineffective to determine the constitutional question and thus to resolve the contingency created by the contest. Assuming, *arguendo*, that the opinion of Congress with respect to the constitutionality were relevant, the fact that Congress, in enacting a statute to replace the contested statute, provided that all monies due under the prior Act should cease to be payable, might as well indicate a Congressional recognition of the invalidity of the prior statute as of its continuing validity but for the legislative repealer. Cf. Pet. 17. Finally it is impossible to perceive how the manner of disposition of the litigation (Pet. 17) could conceivably affect the contingency of the liability during the pendency of the contest.

CONCLUSION

The precise question presented by the petition has already been decided by this Court and the petition should be denied.

Respectfully submitted,

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